

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 03-0403
Adjusted Gross Income Tax
For the Years 1999-2000

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ISSUES

I. Adjusted Gross Income Tax-Unitary filing

Authority: Ind. Code § 6-3-2-2; *Allied-Signal Corp. v. Director, Division of Taxation*, 504 U.S. 768, 781 (1992).

Taxpayer protests the disallowance of its unitary income tax return between itself and various subsidiaries of its parent company.

II. Tax Administration - Penalty

Authority: Ind. Code § 6-8.1-10-2.1; 45 IAC 15-11-2(b).

Taxpayer protests the imposition of the penalties for failing to make estimated quarterly payments.

STATEMENT OF FACTS

Taxpayer is a business engaged in the production of high pressure laminates. Prior to 1999, Taxpayer had filed on a unitary basis with several other companies under a different corporate umbrella. In 1999, Taxpayer was purchased by another corporation. In order to purchase the Taxpayer, its parent corporation had to pay a sum of money to the Taxpayer's prior owner, most of which was financed via debt. This debt was secured by the assets of several companies in the new corporation's group, including Taxpayer.

In early 2000, Taxpayer wrote to the Department, requesting permission to file a combined (unitary) tax return for fiscal year 1999 with itself and other subsidiaries that otherwise did not have Indiana nexus. Such request was made within statutory time limits. The Department sent out a standard letter with respect to that filing. Taxpayer subsequently filed a unitary tax return with various subsidiaries for taxable years 1999 and 2000. Upon audit review, however, Taxpayer's unitary returns were rejected and the Taxpayer was required to be treated as a separate company, based primarily on the lack of flow of goods between Taxpayer and subsidiaries and a lack of distortion of income. Taxpayer filed a timely protest of the assessment.

I. Adjusted Gross Income Tax-Unitary filing

DISCUSSION

Taxpayer protests the imposition of additional adjusted gross income tax with respect to its attempted unitary filing for the taxable years in question, as opposed to the separate company basis proposed by audit. First, Taxpayer argues that the Department granted its permission to file on a unitary basis via its letter, and that such permission should not be withdrawn absent some material element of the request for permission being incorrect or misleading. In general, a taxpayer may be permitted to file on a unitary basis if it requests permission to do so within thirty (30) days of the end of the taxpayer's taxable year, and the Department permits such filing. Ind. Code § 6-3-2-2(q).

First, Taxpayer argues that the Department, in its reply to Taxpayer's letter requesting permission to file a unitary return, granted its permission in the letter. As a result, Taxpayer argues, such permission should not be rescinded absent a material misrepresentation of a taxpayer's circumstances. After review of the Department's letter regarding permission for unitary filing, the language of the Department's letter grants such permission subject to audit review, which is exactly what transpired in this case.

Second, taxpayer argues that the elements for unitary filing are satisfied. Taxpayer notes its operations meet the criteria for unitary filing-namely, functional integration, centralization of management and economies of scale. *See generally Allied-Signal Corp. v. Director, Division of Taxation*, 504 U.S. 768, 781 (1992) (citing *F.W. Woolworth Co. v. Taxation and Revenue Dep't. of New Mexico*, 458 U.S. 354, 364 (1982)). Further, Taxpayer argues that a distortion of income occurred in its operations under Ind. Code § 6-3-2-2(l), which could only be remedied by unitary filing.

Taxpayer has noted the three elements of unitary filing. Taxpayer and the subsidiaries have the same management, satisfying the common management element. With respect to functional integration, Taxpayer has integrated the subsidiaries into one large, functional whole, with substantial flow of value, even without necessarily a flow of goods. Finally, with respect to economies of scale, Taxpayer has noted several aspects of its operations where the Taxpayer and subsidiaries have realized savings from operating as an entity rather than as separate parts. In short, Taxpayer has a well-integrated operation, the type necessary for unitary filing.

With respect to distortion of income, Taxpayer notes several types of distortion that are present within the company. For one thing, Taxpayer notes that many of its clerical services are provided by affiliates, and that Taxpayer is only charged for these services at cost-a fraction of the arms-length price for these services.

In addition, Taxpayer has noted that another member of the unitary group with which it seeks to file has incurred a substantial amount of debt in the acquisition of Taxpayer, and later for additional expenses. Taxpayer's assets are part of the security for both sets of debt. However, Taxpayer's books do not reflect the payment of interest with respect to the debt.

Further, Taxpayer notes that it does not have its own separate sales force, but rather uses the sales force of another member of its claimed unitary group. Taxpayer argues that the fees it is charged are less than the arms-length value of the services provided. Finally, Taxpayer argues that its trademarks are used interchangeably by the businesses without charge.

With respect to Taxpayer's overall operations, it is difficult to quantify what the effects of Taxpayer's transactions leading to the claimed distortion were. In this file, insufficient information exists with respect to whether Taxpayer's intragroup transactions significantly affected Taxpayer's profitability. Finally, with respect to the interest paid for the debt to acquire Taxpayer, Taxpayer's argument that this creates distortion of income with respect to Taxpayer's Indiana operations is difficult to reconcile. Basically, Taxpayer's argument effectively tries to offset its income by the costs of acquiring ... itself. In effect, by permitting unitary filing, Taxpayer transforms the profit of Taxpayer's overall enterprise-which an appropriate filing status, unitary or separate, seeks to accomplish- into a substantially different profit. Rather than being a pre-existing distortion that unitary filing seeks to reduce, the allowance of the interest expense on the unitary return creates a distortion of Taxpayer's income. Thus the unitary filing of Taxpayer and its affiliates is disallowed.

FINDING

Taxpayer's protest is denied.

II. Tax Administration-Penalty

DISCUSSION

Taxpayer also protests the imposition of penalty with respect to its quarterly payments. In particular, Taxpayer argues that, since the penalties were imposed on the basis of failing to remit quarterly income taxes, and were only assessed as a result of the prior assessment, then it is tantamount to the penalty for negligence not otherwise assessed by the Department.

Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC 6-8.1-10-2.1. The Indiana Administrative Code further provides:

(b) "Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

(c) The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay

the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

45 IAC 15-11-2.

With respect to the penalty, Taxpayer has presented a case that it acted with reasonable care expected of taxpayers generally, and thus the penalty should be waived.

FINDING

Taxpayer's protest is sustained.